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Sent via hand delivery and e-mail

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

Re: Berkshire Gas, D.T.E. 04-47
Attorney General's Reply Brief - REDACTED VERSION

Dear Secretary Cottrell:

Pursuant to the procedural schedule adopted in this proceeding, the Attorney General submits this Reply Brief in response to the Initial Brief the Berkshire Gas Company ("Berkshire" or "Company") filed on September 24, 2004. The Attorney General has reviewed the Company's Initial Brief and, except as specifically stated in this reply brief, this review has not caused any change in the positions set forth in his Initial Brief.¹

1. The 2002 Audit Report Has Limited Value.

The Department should carefully review the Company's assertion that the Alliance's internal controls over BP are "reasonable and are functioning as intended;" the Energy East internal audit was "rigorous;" and "BP Energy's operational performance has been exemplary."² The record in this case demonstrates that Energy East's Audit Report was merely a qualified analysis of incomplete data and, therefore, is of limited value.³

Energy East, not Berkshire, conducted the only audit of BP's optimization activities.

¹ No attempt has been made to respond to all of the arguments made and positions taken by the Company. Silence regarding any specific argument in the Company's Initial Brief should not be taken as agreement by the Attorney General.

² Company Brief at 2, 11, 13, 20.

³ At hearing, the Company admitted that the Audit Report did not examine whether BP was acting in Berkshire's best interests. Tr. 1, at 166.

The Energy East audit is flawed and based only on partial data. The audit concluded that <<Confidential

Confidential>> This conclusion is unsupported, however, because the audit team reviewed data just for the months of <<Confidential Confidential>>, not the entire two-year period (April 1, 2002 - March 31, 2004). Exh. AG 1-68 (attachment).⁴

The Company delayed filing the Audit Report until September 17, 2004, three weeks after the discovery period closed. Exh. DTE 1-25(b) (Supp.); Attorney General Initial Brief at 5-6. This delay precluded any in-depth investigation into the Audit Report.⁵ Nevertheless, the Audit Report does show that the Energy East audit team failed to review all pertinent data, specifically:

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Audit Report, p. 4.⁶ The audit team found other failures:

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⁴ The auditors originally restricted their conclusion to just the <<Confidential Confidential>> months tested. Exh. AG 1-68 Att. p. 2. The Company has failed to explain its basis for expanding the auditors' conclusion to cover the entire two-year period. The Company also did not offer proof that the audit included a statistically valid sample of all optimization transactions completed during the contract terms.

⁵ The Attorney General requested additional time to investigate the audit report, but the Department has not yet ruled on that request. AG Initial Brief at 6. In light of the auditors' qualifying statements, the Attorney General renews this request. If the Department allows additional discovery and supplemental briefing, the Attorney General will request copies of the supporting documents referenced in the audit report, seek curricula vitae of the audit team members, and inquire further into the audit review process, its validity and findings. The Attorney General's supplemental inquiry and brief would cover just the Audit Report issues.

⁶ The Company originally requested confidential treatment for the entire Audit Report, but the Company later declassified only the favorable portions of the Audit Report. Company Brief at 2, 20. The Company has not demonstrated how the unfavorable portions of the audit, quoted above, are trade secrets, confidential, competitively sensitive or other proprietary information that deserve confidential treatment under G.L. c. 25, § 5D. They may be embarrassing, but they are not competitively sensitive. *Local Service Provider Freeze*, D.T.E. 99-105, Hearing Officer Ruling at 5 (Apr. 20, 2000). Consequently, the Department should not extend confidential treatment to the Audit Report.

Id. The audit team, consequently, qualified its results.

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Id. The Department should not rely on the Audit Report because the audit process was incomplete and does not support the evaluation for the entire two-year period. In addition, since the parent company, Energy East, conducted the audit, there was no analysis as to whether Berkshire received its fair share of savings or whether any Alliance transactions favored certain affiliates over Berkshire.⁷

2. The Department Should Require the Company To Adhere to Additional Reporting Requirements.

Without repeating the Attorney General's recommended list of auditing and reporting requirements set forth in the Initial Brief,⁸ the Attorney General urges the Department to refocus its oversight of BP's use of Company gas supply assets, especially in the use of derivative transactions. The Company claims that its Agreements will result in the "greatest value for its customers," Company Brief at 6, but the Department cannot evaluate whether this assertion is true unless the reporting process is transparent and complete.

Failure to monitor BP's use of derivatives will allow BP to engage in speculative financing and put the Company's customers at risk. The Company's evaluation of BP's initial and enhanced bids (Exh. AG 1-19[i]),⁹ as well as the Audit Report (Exh. DTE 1-25[b]),

⁷ The Department should structure an independent assessment of BP's performance under optimization agreements, in general, to provide the Company and the Department with insight into the deal making and transaction processes. This would aid all parties by establishing guidelines for structuring and approving future optimization type agreements. These guidelines should include the structure of the necessary related agreements and policies, such as the allocation agreements, netting agreements, derivative policy, audit requirements and procedures.

⁸ AG Initial Brief, pp. 8-9.

⁹The Company tries to minimize BP's reporting shortcomings by claiming the Request For Proposal ("RFP") category, Back Office Systems, is "less significant in terms of benefits to customers." Company Brief at 9. The Company acknowledged that this RFP category is "the ability to generate reports, to provide timely data, to provide detailed information." Tr. 1, at 168. The Company asserted that BP's reporting ability was excellent because BP gave them all the detail they needed. Tr. 1, at 169. As shown above, however, BP did not provide all the data that Energy East requested in its audit. The Department cannot judge with complete certainty whether and to what extent Berkshire customers received benefits under BP's optimization agreement because BP did not retain all pertinent records.

demonstrate that BP needs to improve its back office systems so that the Company, and the Department, can monitor BP's performance accurately.¹⁰

3. Margin Sharing Is Not Justified Under Either Company Proposal.

The Company wrongly assumes that the standard of review for margin sharing under its two proposals -- alliance savings by category or on an aggregate basis (Company Brief 22-23) -- is whether the Company will be penalized for maximizing its optimization. Company Brief at 3, 23. The Department's standard for margin sharing, however, clearly requires consideration of customer interests and is limited to only four categories of LDC transactions -- capacity release, off-system sales, interruptible transportation and interruptible sales. Attorney General Initial Brief at 9-11. Failing to create a fifth category will not penalize the Company; the Department, instead, will be acknowledging that the ratepayers' best interests do not include sharing optimized savings. The Department should reject both Company proposals for margin sharing.¹¹

4. Berkshire Should Refund \$118,021.88 Plus Interest For Legal Fees.

In its initial brief, the Company did not address its recovery of \$118,021.88 in legal fees, which the Company listed as "Cost to file," in the 2003 and 2004 Reports. *See* AG Initial Brief at 15-16; Exh. AG 1-78; Exh. AG 1-4; Exh. AG 1-31.¹² The Department should reject this recovery and order refunds because Berkshire has not shown the Department specifically approved the fees in D.T.E. 02-19 or that the fee resulted from an exogenous event. *See Berkshire Gas*, D.T.E. 04-52, Order at 3-5 (2004) (exogenous costs). Nor can the Company claim that the Department approved the recovery of these costs when it allowed the CGAs for 2003 and 2004 to go into effect. *Western Massachusetts Electric Company*, D.T.E. 03-34, Order at 6 (2004) ("The Department's acceptance sub silentio of a previously approved calculation does not preclude different treatment upon a finding that it is warranted. *Boston Gas Company*, 96-50-C (Phase I) at 33 (1997), *citing Robinson v. Department of Public Utilities*, 416 Mass. 668, 673 (1993) and *NYNEX*, D.P.U. 94-50, at 444 (1995); *see also Fitchburg Gas and Electric Light Company*, D.T.E. 99-66-A at 24 (2001)").

¹⁰ The Department should require Berkshire to increase the weighting of the Back Office System category in any future RFP for optimized savings (currently <<Confidential Confidential>>% of the total amount). Exh. AG 1-19(i). BP ranked a score of <<Confidential Confidential>>, which was significantly worse than the second-place RFP bidder, <<Confidential Confidential>>, which scored a <<Confidential Confidential>>. *Id.* The Department should also require Berkshire to update the Department annually on BP's enhancements to correct this deficiency, including implementing the revised Operating Procedures Agreement and the proposed centralized trading and reporting system. *See* Company Brief, p. 9, n. 6; *Id.* at 21; Tr. 1, at 75-77, 170; Exh. AG 2-7.

¹¹ Company Brief at 23.

¹² The Company also did not show that it sought bids for this legal work as the Department requires. *Berkshire Gas*, D.T.E. 01-56, Order at 73 (2001).

The Department should require the Company to recalculate the CGA reconciliations for 2003 and 2004 removing the \$118,021.88 “Cost to file” amounts and refund the amount plus interest as part of the upcoming peak CGA reconciliation adjustments.

5. Conclusion

For these reasons and those presented in the Attorney General’s Initial Brief, the Department should either reject the Company’s proposals or require the enhanced auditing and reporting requirements. The Department also should reject the Company’s requests for margin sharing of optimized savings and should direct Berkshire to return \$118,021.18 plus interest to its customers through the next CGA reconciliation docket.

Sincerely,

Karlen J. Reed
Assistant Attorney General
Utilities Division

cc: DTE 04-47 staff and Jim Avery (confidential and redacted versions)
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